IT 07-0035-GIL 11/08/2007 ASSESSMENT

General Information Letter: Claiming a subtraction on the wrong line of a return is a mathematical error that must be denied unless the taxpayer can demonstrate the correct nature and amount of the subtraction.

November 8, 2007

Dear:

This is in response to your letter dated August 25, 2007, which has been referred to this office for reply. The nature of your letter and the information provided require that we respond with a General Information Letter (GIL). A GIL is designed to provide general information, is not a statement of Department policy and is not binding on the Department. See 86 Ill. Adm. Code 1200.120(b) and (c), which may be accessed from the Department's web site at www.ILtax.com.

Your letter states as follows:

> As I stated in our conversation, COMPANY is an investment partnership, which invests in other partnerships, which, in turn, have investments principally in real estate. The real estate is located in several states, one of which is Illinois. Enclosed is a copy of COMPANYs' IL-1065, 12/06, which includes a copy of Illinois K-1P, 12/06 reflecting COMPANYs' nonresident member's share. The Illinois Schedule K-1P, allocable to Illinois, shows a net loss. Based in the aforementioned information, please advise the basis on which the tax was assessed.

RULING

Section 903 of the Illinois Income Tax Act ("IITA" ; 35 ILCS 5/903) states in relevant part:

> The amount of tax which is shown to be due on the return shall be deemed assessed on the date of filing of the return (including any amended returns showing an increase of tax). In the event that the amount of tax is understated on the taxpayer's return due to a mathematical error, the Department shall notify the taxpayer that the amount of tax in excess of that shown on the return is due and has been assessed. Such notice of additional tax due shall be issued no later than 3 years after the date the return was filed. Such notice of additional tax due shall not be considered a notice of deficiency nor shall the taxpayer have any right of protest.

IITA Section 1501(a)(12) defines the term "mathematical error" as follows:

> The term "mathematical error" includes the following types of errors, omissions, or defects in a return filed by a taxpayer which prevents acceptance of the return as filed for processing:
>
> (A) arithmetic errors or incorrect computations on the return or supporting schedules;
> (B) entries on the wrong lines;
> (C) omission of required supporting forms or schedules or the omission of the information in whole or in part called for thereon; and
> (D) an attempt to claim, exclude, deduct, or improperly report, in a manner directly contrary to the provisions of the Act and regulations thereunder any item of income, exemption, deduction, or credit.

The copy of the 2006 tax return for COMPANY (Taxpayer) included with your correspondence shows two mathematical errors. First, the return reports negative -10,320 as distributive share of subtraction modifications from a partnership. However, the Schedule K-1-P included with your correspondence identifies Taxpayer's share of partnership subtraction modifications of only $189 relating to an Illinois bonus depreciation subtraction. Second, the return fails to properly report the allocation and apportionment of base income to Illinois in Step 6 of Form IL-1065. The instructions to Form IL-1065 specifically state that if a taxpayer does not complete all of Step 6, the Department may issue a notice and demand proposing that 100% of business income be apportioned to Illinois.

As a result of the mathematical errors contained on Taxpayer's return, additional tax is deemed assessed under IITA Section 903. In this case, such additional tax relates to the disallowance of $10,320 in claimed subtraction modifications and allocation of 100% of the Taxpayer's reported base income to Illinois. However, it appears that the Department incorrectly computed the Taxpayer's 2006 tax by adding the disallowed subtraction modification from Step 5 to total income reported in Step 4 and by including only $460 of the Illinois addition modification reported on Schedule K-1-P. Disallowance of the claimed subtraction modification and allocation of 100% of the Taxpayer's base income to Illinois results in a tax of $12,580. This amount, rather than $12,720, should have been reported on the BTR-76.

Taxpayer's account cannot be adjusted until the mathematical errors on the return are corrected. The following explains how partnership income should be reported and apportioned for Illinois income tax purposes. You may wish to use this information in filing an amended return to correct the errors appearing on the original return.

The Illinois personal property tax replacement income tax imposed on partnerships under IITA Section 201(c) is equal to 1.5% of the taxpayer's "net income" as defined in IITA Section 202. Net income so defined is that portion of the taxpayer's "base income" that is allocable to Illinois under the provisions of Article 3 of the IITA, less a $1,000 standard exemption allowed under Section 204 and any Illinois net operating loss deduction allowed under IITA Section 207. In the case of a partnership, "base income" is defined under Section 203(d) as the amount of the taxpayer's "taxable income" for the year, as adjusted by certain statutory prescribed addition and subtraction modifications. Taxable income for this purpose is defined under IITA Section 203(e)(2)(G) as taxable income determined under section 703 of the Internal Revenue Code (IRC), including separately stated items.

Where a nonresident taxpayer's base income includes distributive share items from a partnership, the method for allocating and apportioning such income to Illinois is provided in IITA Section 305. Section 305 states in relevant part:

> (a) Allocation of partnership business income by partners other than residents. The respective shares of partners other than residents in so much of the business income of the partnership as is allocated or apportioned to this State in the possession of the partnership shall be taken into account by such partners pro rata in accordance with their respective shares of such partnership income for the partnership's taxable year and allocated to this State.
>
> (b) Allocation of partnership nonbusiness income by partners other than residents. The respective shares of partners other than residents in the items of partnership income and deduction not taken into account in computing the business income of a partnership shall be taken into account by such partners pro rata in accordance with their respective distributive shares of such partnership income for the partnership's taxable year, and

> allocated as if such items had been paid, incurred or accrued directly to such partners in their separate capacities.

On the 2006 Form IL-1065, a partnership's base income is reported by completing Steps 2 through 5. Steps 2 and 3 are used to report the partnership's taxable income under IRC Section 703. Addition modifications are reported in Step 4, and subtraction modifications are reported in Step 5. Illinois base income is thus reported on Line 36 of Step 5. The portion of base income so reported that is allocable to Illinois is reported in Step 6. The first step in allocating base income to Illinois is to divide such income between business and nonbusiness income. Accordingly, Line 37 requires the taxpayer to report that portion of the base income from Line 36 that constitutes nonbusiness income, while Lines 38 and 40 require the taxpayer to report that portion of the base income from Line 36 that is business income. Line 38 is used where the taxpayer's base income includes distributive share income from a partnership that is business income in the partnership's hands, and thus allocable to Illinois under IITA Section 305(a). All other business income is reported on Line 40. Lines 41 through 43 are used to report the taxpayer's apportionment percentage, which is applied to the business income reported on Line 40 to determine the portion of such income allocable to Illinois and reported on Line 44. That portion of the taxpayer's nonbusiness income reported on Line 37 which is allocable to Illinois is reported on Line 45 (Schedule NB is used to compute this amount), and that portion of the taxpayer's distributive share of partnership business income that is allocable to Illinois is reported on Line 46. Lines 44 through 46 are then added together and the total carried to Step 7. The taxpayer reports any Illinois net operating loss deduction on Line 49 and claims the standard exemption on Line 53. The final result is Illinois net income reported on Line 54. The partnership's replacement tax is reported in Step 8 by multiplying Line 54 by the tax rate of 1.5%. Any allowable credits are also reported on Step 8 in computing the amount of tax owed.

In this case, Taxpayer should report its taxable income as reported on its federal income tax return in Steps 2 and 3 of Form IL-1065. The Taxpayer should next report its addition modifications in Step 4 and its subtraction modifications in Step 5. Be sure to attach any of the applicable schedules required on the form. Note that Lines 19 and 33 should include the $1,661 and $189, respectively, which have been reported to the Taxpayer on Schedule K-1-P as its share of partnership addition and subtraction modifications. Next is to complete the allocation and apportionment of base income in Step 6. In order to do this the Taxpayer will need to complete Schedule NB. That schedule should include on Line 10, Col. A, the $85,225 of partnership nonbusiness income reported to the Taxpayer on Schedule K-1-P, and on Line 10, Col. B, the $23,603 of partnership nonbusiness income shown as allocable to Illinois. These amounts will be carried over and included on Lines 37 and 45, respectively, of the Form IL-1065, along with any other nonbusiness items. In addition, Taxpayer should include on Line 38 of the Form IL-1065 the ($5) ordinary loss, and the ($122,489) loss from rental real estate reported on Schedule K-1-P, as well as the $1,661 addition modification and $189 subtraction modification related to Illinois bonus depreciation. Note also that the Schedule K-1-P reports the Taxpayer's share of partnership business interest income as negative -4,227. This appears to be an error, as the same amount is reported as a positive $4,227 and reflected as nonbusiness interest income. Accordingly, based on the information provided, it appears that Line 38 should include a total loss from the partnership of ($121,022) (i.e. -$5 + -$122,489 + $1,661 + -$189). Of course, if the Taxpayer has business income from other partnerships these amounts must also be reported on Line 38. Next, the Taxpayer's business income allocable to Illinois must be reported. Assuming that all of the Taxpayer's business income is from partnerships, there will be no amounts entered on Lines 40 through 44. All of Taxpayer's business income allocable to Illinois will be reported on Line 46. This line will include the ($1) ordinary loss and ($33,923) loss from rental real estate, as well as the $460 addition modification and $52 subtraction modification related to Illinois bonus depreciation, reported to the Taxpayer on Schedule K-1-P as apportionable to Illinois. Finally, note that the Schedule K-1-P reports at Line 31, Col. B $23,603 as other income apportionable to Illinois. This appears to be an error as no amount is reported in Line 31 Col. A, and the same $23,603 amount is reported as nonbusiness income in Line 19, Col. B.

As stated above, this is a GIL. A GIL does not constitute a statement of policy that applies, interprets or prescribes the tax laws, and it is not binding on the Department. If you have questions regarding this GIL you may contact Legal Services at (217) 782-7055. If you have further questions related to Illinois income tax laws, visit our website at www.revenue.state.il.us or contact the Department's Taxpayer Information Division at (217) 782-3336.

Sincerely,

Brian L. Stocker
Staff Attorney (Income Tax)